FDC Economic Bulletin

September 07, 2021

As inflation bites, is it now time to buy that house?

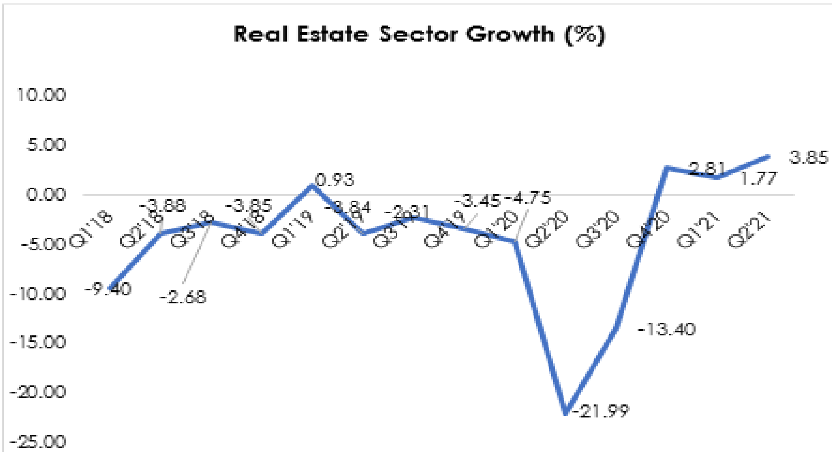
The aggregate supply of housing in any market is usually a function of housing starts (new housing) and completion of the inventory of unfinished houses. Nigeria and Lagos in particular has a huge stock of uncompleted buildings, approximately estimated at 30%. In 2020, housing starts remained stagnant because of low interest rates and the inverse relationship between interest rates and real estate values. Developers rotated their portfolios from financial instruments into other asset classes including real estate, thereby leading to an increase in the supply of housing starts. During the lockdown, rents remained flat and the growth in the real estate and construction sectors fell sharply. In Q2'20, the real estate sector recorded the sharpest contraction in the last 14 quarters to -21.99%. The construction sector also recorded a negative growth of 31.77% in the same period.

In recent times, we have noticed that developers have gone back to site but are constrained by the sharp rise in the cost of building and finishing materials e.g., aluminum windows, roofing sheets, iron rods and cement. Also, more companies have resumed physical work, thereby leading to an increase in demand for shared residential and office spaces. This has now triggered a decline in the vacancy factor in some areas, particularly on the island. Vacancy factor is defined as the number of empty houses compared to occupied buildings. For example, in a street where there are about 50 houses, if 10 are empty that means a 20% vacancy factor.

Real Estate Sector Breakdown

The real estate sector is a lagging economic indicator. This means that growth in the sector takes place after a period of sustained GDP growth. With a population of about 200mn, the house ownership rate in Nigeria is about 25% compared to regional peers like Kenya (75%) and South Africa (56%). It is widely believed that

Nigeria has a housing deficit of about 17 million units. So far in 2021, as economic activities rebound, real estate has maintained a positive growth for two consecutive quarters, with its best performance in Q2'21 (3.85%). On average, the real estate sector has grown by 2.81% in 2021 compared to -9.3% in 2020.



Aggregate demand & supply trends of real estate

The demand for and supply of real estate is currently driven by a number of factors including:

Demand	Supply
• Economic recovery • Back to work • International travel ◊ Increased hotel occupancy rates ◊Availability of Airbnb, short lets • Inflation	• Low interest rates • Exchange rate • High cost of building and finishing materials

Q3'21 FDC Real Estate Survey

Our survey this quarter revealed that the vacancy factor declined to 20% from 25% in Q2'21. This indicates an improvement in sector activities driven by increased investment as interest rates in the fixed income space declined. 364-day tenor t/bills have fallen by 295bps to 6.8%pa from its peak of 9.75% in April.

[1]

There is an inverse relationship between real estate sector growth and vacancy factor. When sector activities improve, vacancy factor declines and vice versa.

Market Breakdown

Hot market: Lekki	Flat Market: Ikoyi	Soft Market: VI
• Vacancy factor index fell to 13% from 21% in Q2'21 • Due to an increase in demand for commercial real estate • Increased supply of short-lets and serviced apartments • Rents marginally down in some areas with close proximity to business districts	• Vacancy factor index increased to 33% from 32% in Q2'21 • Due to high rents for big corporate buildings • Some rents are priced in dollars • Multiple use properties. In the same building you have residential, office spaces, and shopping complexes • Landlords have staying power, meaning that they can leave their properties empty for some time	• Vacancy factor index declined to 19% from 27% in Q2'21 • Driven by rising demand for residential housing units and new shared office spaces springing up • Rents marginally down in some areas with close proximity to business districts • Multiple use buildings • Residential + commercial

[1] NBS, FDC Think Tank

Important trends

- Replacement costs of properties are far in excess of their market values
- Developers are cashing in on long sub-leases
- Landlords are beginning to jack up rents and values especially due to high cost of finishing materials
- Agents and land owners are developing luxury homes while neighboring states, especially Ogun are receiving more settlers from Lagos state on cheaper housing units
- New housing units (mostly 2 & 3 bedrooms, serviced & shared apartments and duplexes) are crowding out self-cons
- People are moving towards more gated estates due to rising insecurity
- Investors are aggressively delving into commercial real estate on the island particularly shared office spaces
- Short-lets & Airbnb are a threat to hotels and are leading to shortage of residential real estate buildings

Challenges & Threats

- **Re-establishment of tollgates:** The Lagos State government is likely to reopen the Lekki tollgate for the first time since the October 20, 2021 EndSars protest incident. This will worsen traffic congestion in that axis and possibly taper demand for new housing units.

- **High price of building materials:** Quite a number of building materials especially finishing materials like aluminum, roofing sheets, and iron rods used in Nigeria are imported due to insufficient local supply to meet demand. The price of aluminum has spiked by 33% to $2,650/mt YTD, and it is imported from China. Once importers factor in the weaker exchange rate (at a record low of N532/$ at the parallel market), the domestic price of these commodities will also rise accordingly. In addition, the price of locally priced commodities like cement is also up 150% to N4,000 per bag.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- **Poor rail networks:** There is need for good rail systems in Nigeria, especially in Lagos state. This will reduce demand for housing units and invariably divert demand to neighboring states (Ogun & Oyo). This will taper congestion and support the development of these other states. Experts have estimated Nigeria's infrastructure gap to be $3trn.

Real estate sector outlook

We expect the improvement in economic activities and low interest rate environment to support the real estate sector growth in Q3. The demand for commercial real estate, especially office space, will continue to rise as more companies resume physical work. The demand for residential housing units is likely to fall as consumer disposable income remains squeezed. Luxury real estate like hotels will keep springing up in highbrow areas. However, there is the increasing need for more government interventions to address the housing deficit in the country.